No. 80-1104

In the

# Supreme Court of the United States

OCTOBER TERM, 1980

STEWART-WARNER CORPORATION,

*Petitioner,*

*vs.*

WESTERN ELECTRIC COMPANY, INCORPORATED,

*Respondent.*

(On Petition For Writ of Certiorari To The United States Court of Appeals For the Fourth Circuit)

## PETITIONER'S REPLY BRIEF

THEODORE R. SCOTT
McDOUGALL, HERSH & SCOTT
135 South La Salle Street
Chicago, Illinois 60603
(312) 346-0338
*Counsel of Record for Petitioner*

The Scheffer Press, Inc.—(312) 263-6850

## CORPORATE AFFILIATES

Stewart-Warner Corporation is a Virginia corporation having its principal place of business in Chicago, Illinois; it does not have a parent corporation.

Stewart-Warner Corporation's subsidiaries (except wholly owned subsidiaries) are (1) Stewart-Warner Alemite Sales Company of Northern California, Inc. (San Francisco), (2) Stewart-Warner Alemite Sales Company, Inc. (Union, New Jersey), (3) Stewart-Warner Alemite Sales Company of Eastern Pennsylvania (Philadelphia), (4) Amcaster Company of South Africa (Pty.) Limited (South Africa), (5) Industrial Alemex, S.A. (Mexico), (6) Stewart-Warner France, S.A. (France), and (7) Wadco Tools Pty. Limited (India).

Stewart-Warner Corporation does not have any other affiliates.

# TABLE OF CONTENTS

PAGE

Argument ..... 2

Conclusion ..... 7

## Table of Cases

*Laitram Corporation* v. *King Crab, Inc.* (D.C.Alaska, 1965), 245 F.Supp. 1019 ..... 3

*Peelers* v. *Wendt* (W.D.Wash., 1966), 260 F.Supp. 193 ..... 3

*Rocform Corp.* v. *Acitelli-Standard Concrete Wall, Inc.*, (6 Cir., 1966), 376 F.2d 678 ..... 3

*Westinghouse Co.* v. *Wagner Mfg. Co.* (1912), 225 U.S. 604 ..... 7

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1980

---

## *No. 80-1104*

---

STEWART-WARNER CORPORATION,

*Petitioner,*

*vs.*

WESTERN ELECTRIC COMPANY, INCORPORATED,

*Respondent.*

---

(On Petition For Writ of Certiorari To The United States Court of Appeals For the Fourth Circuit)

---

## PETITIONER'S REPLY BRIEF

---

This is not an "ordinary patent case" (Western Electric brief, p. 1) in which this Court is being asked to *correct* a misapplication of the existing law of patent misuse by the courts below.

This is a case in which this Court is being asked to *extend* the law of patent misuse to prohibit discrimination against single patent licensees (or applicants for single patent licenses) by requiring that single patent licenses be offered on terms and conditions that are proportionally equal to the terms and conditions afforded to package licensees.

## ARGUMENT

Western Electric's brief presents an erroneous, narrow perspective of the importance of the legal issues for which review is sought by Stewart-Warner's petition to this Court.

This is not an ordinary package licensing case in which Western Electric's position can be justified merely because it offered Stewart-Warner "a viable economic alternative" to a package license.

Although Western Electric argues that its package licensing program can be justified on that basis, a much different standard of licensing conduct was established for Western Electric by the terms of the antitrust consent decree entered against it in 1956. That decree, which required Western Electric to grant licenses under "any, some or all" Bell System patents for royalties that are "non-discriminatory as between licensees" (DX 158, pp. 7 and 9), necessarily dictated a stricter licensing standard for the Bell System, but the courts below did not hold Western Electric to that standard.

Instead, by allowing Western Electric to offer advantageous options to package licensees which were not made proportionally available to Stewart-Warner when it applied for a single patent license, the courts below have sanctioned discrimination—plain and simple—in the largest licensing program in the United States, involving hundreds of licensees and millions of dollars in royalties.

Stewart-Warner's petition affords this Court the opportunity to determine, and announce to the lower fed-

eral courts, whether the common law of patent misuse prohibits discriminatory licensing practices in the context of an industry-dominating patent in an industry-dominating portfolio.

So far as Stewart-Warner is aware, that subject has never been addressed by this Court, but the first step in the formulation of such a rule has already been taken in the decisions of the District Courts in *Laitram Corporation* v. *King Crab, Inc.* (D.C.Alaska, 1965), 245 F. Supp. 1019, and *Peelers* v. *Wendt,* (W.D.Wash., 1966), 260 F.Supp. 193.

Stewart-Warner's petition also affords this Court the opportunity to determine the metes and bounds of discriminatory licensing within the context of the 1956 consent decree as it applies to the Bell System—another facet of discriminatory licensing about which there is little authority.

As licensing agent for the Bell System, Western Electric oversees the most important patent portfolio in the United States. And the Derick-Frosch patent involved in this case has been correctly characterized as both "basic" and "fundamental" to the manufacture of integrated circuits.

Even so, Western Electric contends that the issues of this case are unimportant because the Derick-Frosch patent had expired before this suit was brought. But basic about-to-expire patents can be effective tools to compel discriminatory package licensing (*Rocform Corp.* v. *Acitelli-Standard Concrete Wall, Inc.* (6 Cir., 1966), 376 F.2d 678, 681). Many opportunities will exist for the Bell System to repeat that tactic if the decisions of the lower courts in this case are allowed to stand.

Western Electric used its basic but about-to-expire Derick-Frosch patent as leverage to effect the licensing of some of its non-expiring patent deadwood—patents such as the Andrus, Pfann and Kliemack patents, which Western Electric carefully avoided litigating in the approximately one-dozen actions for infringement of the Derick-Frosch patent that were consolidated for discovery by the Judicial Panel on Multidistrict Litigation. But it was the royalties to be paid for the continuing use of those questionable patents that would guarantee a flow of future income to the Bell System, after the Derick-Frosch patent had expired.

The Bell System has a standard practice of taking grant-back licenses from virtually all of its licensees. As a matter of fact, the Bell System has a right to demand such grant-back licenses under the 1956 consent decree (DX 158). In return it offers an option for a substantial cash-royalty rebate to all qualified concerns having a potential for technological development. Western Electric now argues that Stewart-Warner suffered no "competitive disadvantage" (Western Electric brief, p. 8) when it withdrew that option. But that option is of substantial economic value to small semiconductor concerns, such as Stewart-Warner Microcircuits. If it were not, 90% of Western Electric's licenses would not have requested and been granted such an option, and there would have been no incentive, no logic, and no reason for this lawsuit.

Stewart-Warner qualified for a ½% grant-back reduction based upon Western Electric's multiple-inspection of Stewart-Warner's research facilities and personnel. But when Stewart-Warner rejected a four-patent package license which included three patents of dubious quality, Stewart-Warner promptly lost the promised

royalty rebate option—even though it had previously been told that such a rebate was available even if it took a license under one patent only (PX 81-A).

The Court of Appeals, without critical analysis, rejected Stewart-Warner's contention of discrimination because, in the Court's own words, "The evidence showed that Western had never given a grant-back reduction when a single patent was licensed" (Petition, 11a). In short, the Court of Appeals held that there could be no illegal discrimination unless there was an existing "clone" for the agreement requested by Stewart-Warner.*

This rule of law renders the 1956 consent decree a practical nullity, and it gives the Bell System an excuse to withhold advantageous economic options from prospective licensees in a highly competitive market. In the analogous law relating to commodity price discrimination under the Robinson-Patman Act, discriminatory rebates disguised in the form of promotional allowances, commissions, etc. are logically outlawed (15 USC § 13). The aggrieved party does not have to establish an existing "clone" type transaction.

---

* The superficial analysis of Stewart-Warner's charge that Western Electric discriminated against it is also demonstrated by the fact that the Special Master, the District Court and the Court of Appeals not only entertained but endorsed Western Electric's argument that it legitimately feared a charge of illegal coercion if it gave Stewart-Warner a grant-back royalty rebate in a single patent license. What more could Stewart-Warner possibly have done than write the letter which it wrote to Western Electric, stating that "the inclusion of a grant-back clause in the license agreement is made entirely at the request of the Stewart-Warner Corporation" and thus "should alleviate any such apprehension" (DX 137) on the part of Western Electric?

The licensing of any, some or all of the patents in an industry-dominating patent portfolio on proportionally equal terms is the standard that must be applied by this Court, in order to stop patent licensors from discriminating against applicants for licenses under one or two patents only.

Western Electric also contends that Stewart-Warner's petition presents nothing more than a factual dispute which "is of interest only to the parties to this lawsuit" (Western Electric brief, p. 4) and which the courts below had no difficulty in resolving. But the reality is that the petition presents an important evolving question of patent misuse about which the Court of Appeals stated:

> "On the whole case, we agree with the conclusion of the master and the district court that 'it cannot be said that it was an open and shut case all along for either party'" (Petition, 8a).

With respect to the second question presented by Stewart-Warner's petition, Western Electric does not deal with the illogic or the stifling economic effect of permitting process claims in a United States patent to cover foreign processing operations. The courts below circumvented the time-honored rule that the vitality of a United States patent expires at the border by using the entire market value of the semiconductor products marketed by Stewart-Warner as the basis for awarding damages to Western Electric. And they did so despite the devastating admission of Western Electric's expert witness that the inventions of five other U.S. patents were incorporated in the Stewart-Warner semiconductor products (R. XXVII at 674-677; PX 100, pp. 16-17), and in complete disregard of this Court's decision in

*Westinghouse Co.* v. *Wagner Mfg. Co.* (1912), 225 U.S. 604, 614-615.

If the decision of the Court of Appeals is allowed to stand, this second licensing loophole will enable Western Electric to collect royalties on the value added through foreign manufacturing operations by the several dozen U.S. companies which routinely ship integrated circuit chips abroad for encapsulation into complete devices.

## CONCLUSION

This Court should grant Stewart-Warner's petition for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit and proceed to consider and resolve the questions of patent misuse and unwarranted extension of the entire market value rule presented by that petition.

Respectfully submitted,

THEODORE R. SCOTT
McDOUGALL, HERSH & SCOTT
135 South La Salle Street
Chicago, Illinois 60603
(312) 346-0338
*Counsel of Record for Petitioner*